

Internal Revenue Service  
**memorandum**

CC:TL-N-3317-90

Br4:JTChalhoub

date: **APR 20 1990**

to: District Counsel, Dallas SW:DAL  
Attn: James W. Lessis, Special Litigation Assistant

from: Assistant Chief Counsel (Tax Litigation) CC:TL

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subject: [REDACTED] Pre-90  
Request For Tax Litigation Advice

This is in reply to your January 30, 1990, request for formal tax litigation advice.

### ISSUES

1. Whether a subsequently executed restricted Form 872-A has the effect of superseding a prior unrestricted Form 872-A for the same tax year.
2. Assuming, arguendo, the subsequent Form 872-A superseded the earlier one, whether the proposed deficiency adjustments are within the scope of the restrictions on the subsequent consent.
3. Whether an IRS letter sent to the taxpayers indicating the discontinuance of an examination for [REDACTED] on the erroneous ground the statute of limitations on assessment had expired was an act of termination of the consent for [REDACTED].

### CONCLUSIONS

1. The issue of whether a restricted Form 872-A consent can supersede an unrestricted Form 872-A consent is a question of fact, based upon the intention of the parties. See the attached copy of G.C.M. 39376, CC:I-115-85, District Director, Denver, (June 25, 1985). There is as yet no clear indication of intent for the subsequent restricted Form 872-A to supersede the earlier unrestricted Form 872-A in this case. The facts on this issue will have to be further developed.
2. Whether proposed adjustments in the notice of deficiency are within the scope of restrictions in a valid consent is also an issue of fact to be determined from the intention of the parties and the surrounding facts and circumstances. Arguably, the restricted consent does not exclude pass through adjustments from any entity as

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being outside the scope of the restriction. Development of further facts to overcome facts in the administrative file that favor the taxpayer will be necessary. Thus, we are unable to conclude with any certainty whether the restriction applies to the Schedule C adjustment and the ITC carryback.

3. Form 872-A may only be terminated by one of the methods prescribed in the consent. Grunwald v. Commissioner, 86 T.C. 85 (1986). The letter from the Service indicating that the statute of limitations on assessment had expired was not one of these methods, but was an erroneous conclusion of law. The Service would not be bound by the acts (or statements) of its agents in making erroneous conclusions of law and communicating such erroneous conclusions to the taxpayer.

### FACTS

Taxpayers [REDACTED] filed a joint return for the tax year [REDACTED] on [REDACTED]. We assume that no extensions of time were applied for or granted. At the same time the taxpayers filed the [REDACTED] return, they filed a claim for refund claiming an investment credit carryback from [REDACTED] to [REDACTED]. We assume, although your incoming request does not so state, the claim for [REDACTED] was tentatively allowed and the Dallas Appeals Office now proposes to include a deficiency for that year in the amount of \$[REDACTED]. On [REDACTED] the taxpayers executed an unrestricted Form 872-A extending the period of limitation on assessments for the [REDACTED] tax year indefinitely. Such consent was accepted for the Commissioner by signature of Mary A. Rude, dated [REDACTED]. On [REDACTED], the taxpayers executed another Form 872-A, but this Form 872-A had a restriction paragraph. This second Form 872-A was also countersigned for the Commissioner by Mary A. Rude on [REDACTED]. There is no indication from the second document that it supersedes a prior Form 872-A executed by the taxpayers and the Service.

The restriction paragraph contained in the second Form 872-A reads as follows:

- (5) The amount of any deficiency assessment is to be limited to that resulting from any adjustment to: (a) the taxpayer's distributive share of any item, of income, gain, loss, deduction, or credit of, or distribution for any small business corporation(s), partnership(s) or organizations treated as partnerships on the taxpayer's tax return, trust, estate, nominee and any other entity from which tax attributes pass to or are properly reportable by taxpayer;

(b)-the tax basis of the taxpayer's interest in any of the above-mentioned entities; and (c) any gain or loss (or the character or timing thereof) realized upon the sale or exchange, abandonment, or other disposition of taxpayer's interest in any of the above-mentioned entities: including any consequential changes to other items based on such adjustment. This 872A also covers any addition(s) to tax which may be appropriate as a result of the facts and circumstances surrounding any adjustment(s).

Both consents have dates typed near the top of the form. The significance of the [REDACTED] date typed at the top of consent #1, and the [REDACTED] date typed at the top of consent #2 is unexplained. We assume this was a reference to the assessment statute expiration date (ASED) as concluded by the person who prepared the Form 872-A that was sent to the taxpayer for signature. These extra dates can only confuse a judge and appear to be hazards of litigation. The taxpayers have not filed any Form 872-T to terminate either consent.

On or about February 28, 1988, the Service sent the taxpayers a letter which states as follows:

We have discontinued action concerning the deficiency disclosed by our examination of your [REDACTED] Federal Income Tax Return, because the statutory period in which we could legally have assessed the deficiency has expired.

The enclosed examination report for that year shows the tax we believe would have been due had the statute not expired. The report is for your information. You have no legal obligation to pay the deficiency shown in it.

The taxpayers have taken the position with the Office of Appeals in Dallas that the subsequently executed restricted consent supersedes the earlier unrestricted consent. They further contend that the proposed adjustments are outside the scope of the restrictions on the second Form 872-A. Lastly, they contend, in the alternative, that a letter received from the Service, which alleges expiration of the statute of limitations for [REDACTED], operates as a termination of the consent. Thus, the taxpayers contend their consent has expired.

## DISCUSSION

Section 6501(c)(4) of the Code provides authority for an exception to the statute of limitations on assessment, whereby the statute may be extended by an agreement of the parties executed on or before a date three years after the return was filed. The Code allows for subsequent agreements provided they, too, are executed on or before the expiration of an existing agreement.

Two types of consent are in general use by the Service, Form 872 and Form 872-A. Generally, a Form 872 agreement precedes a Form 872-A agreement, but that did not occur in the instant case. Form 872-A was executed less than three years after the filing of the return on [REDACTED]. The correct ASED would have been [REDACTED] a [REDACTED] and not a legal holiday. It will be necessary to question the person or persons who placed the typewritten dates at the top of Forms 872-A to learn the intention of the Service with respect to such dates on each Form 872-A.

Indefinite consents on Form 872-A have been held by the courts to be valid. See, e.g., *Winn v. Commissioner*, 67 T.C. 499, 507-509 (1976), affd. in part and rev'd. in part 595 F.2d 1060 (5th Cir. 1979); *McManus v. Commissioner*, 65 T.C. 197, 207-208 (1975), affd. 583 F.2d 443 (9th Cir. 1978); and *Grunwald v. Commissioner*, 86 T.C. 85, 88 (1986). I.R.C. § 6501(c)(4) "refers only to time, and leaves the parties free to decide for themselves the terms on which an extension will be granted." *Pursell v. Commissioner*, 38 T.C. 263, 278 (1962), affd. per curiam 315 F.2d 629 (3rd Cir. 1963).

1. The Service has taken the position in G.C.M. 39376 that a restricted Form 872-A did not supersede an unrestricted Form 872-A on the facts given in that case. Moreover, the Tax Court held in *Grunwald v. Commissioner*, supra, that once a valid Form 872-A has been executed, the only method of terminating the consent is one of the methods specifically provided for in the consent. The facts as given in G.C.M. 39376 indicate two separate agents working the taxpayer's return. One agent was examining the whole return for the year [REDACTED] and another agent was examining the partnership of which the taxpayer was a partner. This is similar to the separate examination conducted in *Podell v. Commissioner*, T.C. Memo. 1987-22. However, *Podell* involved a subsequent Form 872 rather than another Form 872-A. The Tax Court opinion in *Podell* indicates that two separate districts were involved. G.C.M. 39376 takes the position that supersession is a different act from termination. Thus, intention of the parties may not be an obsolete concept as you suggest in your request for tax litigation advice.

Here, the facts indicate that Mary A. Rude signed both consents for the Commissioner. She may (or may not) remember that she signed both an unrestricted and a restricted consent for the same year and for the same taxpayer only five days apart. These facts present serious hazards of litigation unless they can be successfully explained. The question to be resolved is whether she intended the second Form 872-A to supersede or replace the prior one. Assuming she did not remember, was the same agent the preparer of both documents? Did the examining agent and the taxpayer intend the second document to replace the first one. This is a factual issue and evidence will have to be developed before you decide to reject the second Form 872-A as not controlling. If, as you propose, there was no clear indication of an intention to supersede the first Form 872-A with the second, then the second would not be controlling. For example, if the Service could prove that two different revenue agents from different groups, one working without the knowledge of the other, furnished the taxpayers with Form 872-A, the Tax Court would probably agree that there was no intention to supersede the unrestricted Form 872-A with the restricted Form 872-A. The stated facts are inconclusive with respect to intent.

2. Assuming, arguendo, that it cannot be proved Mary A. Rude and the Service did not intend supersession of Form 872-A with the restricted document, then the restricted consent becomes operative. The question is whether the restriction was intended to apply to the Schedule C adjustment involving "audio cassettes." On the facts submitted, we are unable, without further factual development, to clearly conclude the restriction did not apply to "[REDACTED]" or "[REDACTED]" both of which involve losses claimed on the taxpayers' Schedule E for [REDACTED]. One entity is apparently a partnership and the other is apparently an "S" corporation. These contrary facts must be overcome by other overriding facts, e.g. communications with the Service, transmittal letter sending the restricted Form 872-A identifying the shelter reflected on Schedule C, etc. If the taxpayers' intention in signing the restricted consent can be proven to apply to "audio cassettes" or the "[REDACTED]" transaction, then the Tax Court will, in our view, have no difficulty in finding that the restrictions were intended to apply to the proposed disallowance of the loss on Schedule C and the investment credit recapture of \$[REDACTED] for [REDACTED] and \$[REDACTED] carryback to [REDACTED]. See the following cases wherein "restrictions" have been interpreted in favor of the Service: *Adler v. Commissioner*, 85 T.C. 535 (1985); *Kronish v. Commissioner*, 90 T.C. 684 (1988); *Schulman v. Commissioner*, 93 T.C. 623 (1989); *Courson v. Commissioner*, T.C. Memo. 1990-196; *Marinos v. Commissioner*, T.C. Memo. 1989-492; *Smith v. Commissioner*, T.C. Memo. 1989-432; *Roussello v. Commissioner*, T.C. Memo. 1989-391; *Brody v. Commissioner*, T.C. Memo. 1988-203.


3. Irrespective of which consent, the restricted or the unrestricted, is determined to be controlling, the consent is a unilateral waiver of a defense and is not a contract. However, contract principles are important because I.R.C. § 6501(c)(4) requires a written agreement as to the terms of the consent to extend the statute. *Grunwald v. Commissioner*, 86 T.C. 85, 89 (1986); *Piarulle v. Commissioner*, 80 T.C. 1035, 1042 (1983). If the specifications for termination of the consent were agreed to by the taxpayers and the Service, then termination can only occur by means of one of those specifications. *Grunwald v. Commissioner*, supra.

A cardinal rule of law is that the Commissioner is empowered retroactively to correct mistakes of law in the application of the tax laws to particular transactions. He may do so even where a taxpayer may have relied to his detriment on the Commissioner's mistake. *Dixon v. United States*, 381 U.S. 68, 72-73 (1965); *Automobile Club of Michigan v. Commissioner*, 353 U.S. 180, 183-184 (1957). Thus, the Commissioner is not responsible nor bound by erroneous legal advice given to a taxpayer by one of his agents. *Martin's Auto Trimming, Inc. v. Riddell*, 283 F.2d 503, 506 (9th Cir. 1960); *Peek v. Commissioner*, 73 T.C. 912 (1980). When the taxpayer received the letter from the Service on or about [REDACTED] concluding, erroneously, that the statute of limitations had expired, the letter stated a legal conclusion that was wrong as a matter of law. Thus, the Commissioner is not estopped from issuing a deficiency notice, so long as the adjustments fall within the scope of whichever consent is contended to be controlling. It will be important for Appeals to monitor closely the administrative file, in case the taxpayers decide to send Form 872-T to the Service.

We have purposefully declined to discuss the case cited by the taxpayer's counsel, *Farmers Union State Exchange v. Commissioner*, 30 B.T.A. 1051, 1066-1068 (1934), for the reason that Form 872-A (whether unrestricted or restricted) provides specific clauses on how an indefinite consent may be terminated. This was not the case in *Farmers Union*. Thus, supersession of the unrestricted consent will be a separate fact question based upon intention of the parties. It is entirely possible that Mary A. Rude, or the revenue agent who prepared both consents may have intended to correct a mistake in sending the first consent. The facts on this will have to be developed. Using contract principles, the parties may undo what they mistakenly did, if they both intended it that way. For a case decided contrary to *Farmers Union*, see *Simmons v. Commissioner*, 76 F. Supp. 442 (S.D. C.D. Cal. 1948). If, however, separate revenue agents were dealing with the taxpayers at the same time (duplicate administrative files are alleged to have been created), then, obviously, the second consent was sent to the taxpayer without knowledge of the existence of the first consent and the Commissioner did not intend to correct a mistake. Mary A. Rude may not remember, although she signed both consents along with many others. In

that event, only the termination clauses on Form 872-A (rather than supersession) can operate to terminate the first unrestricted consent. If you have any questions concerning this matter, please contact Joseph T. Chalhoub at FTS 566-3345.

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By:   
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Enclosure:  
G.C.M. 39376